

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE**

In Re:	§	Chapter 11
	§	
W.R. GRACE & CO., et al.,	§	Jointly Administered
	§	Case No. 01-01139 (JKF)
Debtors.	§	
	§	

**FEE AUDITOR'S FINAL REPORT REGARDING
FEE APPLICATION OF STEPTOE & JOHNSON, LLP
FOR THE FIFTH INTERIM PERIOD**

This is the final report of Warren H. Smith & Associates, P.C. ("Smith"), acting in its capacity as fee auditor in the above-captioned bankruptcy proceedings, regarding the Interim Fee Application of Steptoe & Johnson, LLP for the Fifth Interim Period.

BACKGROUND

1. Steptoe & Johnson, LLP ("Steptoe") was retained as special tax counsel to the Debtors. In the Application, Steptoe seeks approval of fees totaling \$108,822.50 and costs totaling \$7,433.40 for its services from April 1, 2002 through June 30, 2002.
2. In conducting this audit and reaching the conclusions and recommendations contained herein, we reviewed in detail the Application in its entirety, including each of the time entries included in the exhibits to the Application, for compliance with 11 U.S.C. § 330, Local Rule 2016-2 of the Local Rules of the United States Bankruptcy Court for the District of Delaware, Amended Effective February 1, 2001, and the United States Trustee Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. 330, Issued January 30, 1996, (the "Guidelines"), as well as for consistency with precedent established in the United States

Bankruptcy Court for the District of Delaware, the United States District Court for the District of Delaware, and the Third Circuit Court of Appeals. We served on Steptoe an initial report based on our review, and received a response from Steptoe, portions of which response are quoted herein.

DISCUSSION

General Issues

3. In our initial report we noted that timekeepers AEM and JWJ often did not include sufficient detail in their time entries. Rule 2016-2(d) of the Delaware Local Rules states “activity descriptions . . . shall be sufficiently detailed to allow the Court to determine whether all the time, or any portion thereof, is actual, reasonable, and necessary . . .”. We asked Steptoe to advise these professionals to provide additional detail in future time entries.

4. In our initial report we noted that timekeepers JMB, AEM and SHS often tended to lump their time entries. Local Rule 2016-2(d)(vii) provides that “[a]ctivity descriptions shall not be lumped – each activity shall have a separate description and a time allotment.” We asked Steptoe to advise these professionals to avoid lumping their time entries in the future.

5. In our initial report we noted that the Application has a summary of expenses but fails to provide a list of expense details. The Guidelines Rule II. E. provides that “[f]actors relevant to a determination that the expense is proper include the following: . . .3. Whether applicant has provided a detailed itemization of all expenses including the date incurred, description of expense (e.g., type of travel, type of fare, rate, destination), . . .”. Thus we asked Steptoe to please provide detailed expense entries with regard to those expenses for which reimbursement is requested. Steptoe provided us with the appropriate information and thus we have no objection to these expenses.

Specific Time and Expense Entries

6. In our initial report we noted that during the Application period multiple Steptoe professionals spent 202.9 hours for a total expense to the estate of \$71,951.00 on “COLI” issues.(See Exhibit A). This amount represented 66% of the total Fee Application. Local Rule 2016-2 (d) requires that “[s]uch motion shall include activity descriptions which shall be sufficiently detailed to allow the Court to determine whether all the time, or any portion thereof, is actual, reasonable, and necessary”. The narrative and the individual time entries were essentially void of detail with regard to this project. Thus we asked Steptoe to provide additional information with regard to this project. Steptoe response is provided in Response Exhibit 1. We accept this response and thus we have no objection to these fees.

7. In our initial report we noted that during this application period Steptoe spent 41.1 hours and \$15,412.50 preparing its own fee applications. A.E. Moran, with an hourly rate of \$375.00, was the only professional from Steptoe that billed time to fee application preparation. The U.S. Trustee Guidelines Rule, I.E. states “. . . [i]n evaluating fees for professional services, it is relevant to consider various factors including the following: the time spent; the rates charged; whether the services were necessary to the administration of, or beneficial towards the completion of, the case at the time they were rendered; whether services were performed within a reasonable time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; . . .”. We noted that in our experience, the majority of the preparation of one’s own fee application is routinely performed by paraprofessionals and clerical personnel. We asked Steptoe to explain why professionals with lower billing rates were not utilized for this matter. Steptoe responded as follows:

The auditor noted that most firms use paralegals or non-attorneys to prepare bills. Steptoe does use an accounting staff who prepares the initial invoices, and I review them as billing partner. Now that I have the quarterly and monthly applications on a grid, I have my secretary fill in the costs and I review them.

The significant time spent preparing and reviewing the bills in April was due to a number of factors. First, you will note that a significant amount of time was spent on October bills and 2001 submissions. This is because we had assumed Grace would pay us the October bill as an ordinary course professional (it had been under \$50,000, we understood that we only needed to file for the July and September bills, which exceeded that amount, and from November onward). The judge's order, issued in January of 2002, required submission of all bills beginning in July, 2001. We therefore had to spend some extra time with the October bills trying to put them in proper order for an application.

This was also the first time we had filed quarterly reports and certificates of no objection, which had to be prepared, reviewed and standardized, and establish a procedure for monitoring our submissions to the court. I think you will see a significant drop in the cost of billing in future applications. Nonetheless, as I am sure you appreciate, the review of the work prepared by others is time consuming, particularly when we must be sure that the changes are properly recorded and applied to the proper category. It is more efficient for me to do the review than for someone who is not familiar with the case. Nonetheless, I do attempt to delegate as many administrative tasks as I can.

We believe we understand Steptoe's response, which points out these fees were for preparing prior applications. We also note that the cumulative fees for Steptoe through June 2002, are \$405,198.50, and Steptoe's cumulative charges for preparing its own fee applications is \$30,392.00. However, since a reduction for these charges was taken in the fourth interim period in the amount of \$5,740.00, the total adjusted amount Steptoe charged for preparing its own fee application is \$24,652.00, which is just slightly over 5% of Steptoe's cumulative fees. Thus we have no objection to these fees.

8. Thus, we recommend approval of fees totaling \$108,822.50 and costs totaling \$7,433.40 for Steptoe's services from April 1, 2002 through June 30, 2002.

Respectfully submitted,

WARREN H. SMITH & ASSOCIATES, P.C.

By:



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FEE AUDITOR

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document has been served First Class United States mail to the attached service list on this 5th day of October, 2002.



Warren H. Smith

SERVICE LIST

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EXHIBIT A

04/01/02	A.L. Bailey	Review recent COLI TAM.	1.20
04/01/02	B. Kaufman	Meeting with A. Moran to answer C. Finke questions re: COLI landscape	0.50
04/29/02	A.E. Moran	Telephone conference with C. Finke re Response to IDRs and COLI settlements.	0.50
04/30/02	A.E. Moran	Review COLI articles and other issues	2.80
05/06/02	A.L. Bailey	Develop strategy with regard to COLI Fast-Track.	0.50
05/06/02	A.E. Moran	Review COLI legislation and subsequent activities.	0.80
05/06/02	S.H. Serling	Telephone conference with Grace and Anne Moran regarding COLI settlement options.	1.00
05/06/02	S.H. Serling	Review COLI litigation.	0.50
05/06/02	J.W. Johnson	Teleconference with Grace re COLI tax procedures.	1.00
05/06/02	J.W. Johnson	Draft request to IRS for expedited COLI consideration.	2.00
05/06/02	J.W. Johnson	Research COLI operational issues.	2.00
05/07/02	S.H. Serling	Attention to COLI litigation.	0.50
05/07/02	J.W. Johnson	Research regarding COLI operational issues.	3.20
05/07/02	J.W. Johnson	Draft and revise letter to IRS re COLI settlement.	1.00
05/08/02	A.L. Bailey	Advice regarding COLI operational issues.	0.40
05/08/02	J.W. Johnson	Revisions to IRS letter related to expedited settlement of COLI issue.	0.80
05/08/02	J.W. Johnson	Analyze COLI operational issues related to COLI settlement.	1.80
05/09/02	J.M. Baxley	Review of COLI operations.	1.50
05/09/02	J.W. Johnson	Research COLI operations issues per COLI settlement.	2.20
05/10/02	J.M. Baxley	Research re: review of COLI operations.	3.00
05/10/02	J.W. Johnson	(COLI Operations) research related to COLI settlement.	1.50
05/13/02	J.M. Baxley	Research re: COLI operations; begin drafting memorandum.	4.50
05/14/02	B. Kaufman	Review of COLI case filings and decision.	0.50
05/14/02	J.M. Baxley	Research re: COLI operations; continue drafting memorandum.	5.50
05/15/02	J.M. Baxley	Research re: COLI operations.	5.50
05/16/02	A.L. Bailey	Prepare for call regarding COLI cases.	0.50
05/17/02	A.E. Moran	Review recent COLI cases.	2.50

05/17/02	A.L. Bailey	Review information from other companies re COLI operations.	0.50
05/17/02	J.M. Baxley	Review cases re: COLI operations.	5.50
05/19/02	J.M. Baxley	Research and drafting re: review of COLI operations.	7.50
05/20/02	J.W. Johnson	Review research re COLI operational issues.	2.20
05/20/02	J.M. Baxley	Read cases and draft memorandum regarding review of COLI operations.	7.00
05/21/02	S.G. Watters	Review state legislative history regarding COLI.	1.00
05/21/02	A.E. Moran	Conference call on COLI litigation (AEM attended only part).	0.50
05/21/02	A.E. Moran	Prepare for conference call on COLI litigation.	0.20
05/21/02	J.W. Johnson	Research relating to COLI settlement.	3.00
05/21/02	A.L. Bailey	Call Avon Consulting regarding policyholder reactions to COLI cases.	1.20
05/21/02	S.H. Serling	Conference call regarding COLI litigation with Art Bailey, Anne Moran, Carol Finke, Rick Sentfleben, and Elyse Napoli.	0.80
05/22/02	S.G. Watters	Continue review of state legislative history regarding COLI.	1.00
05/22/02	J.W. Johnson	Research regarding issues related to COLI policies and IRS settlement issues.	4.50
05/22/02	A.E. Moran	Follow up on COLI litigation.	0.80
05/23/02	J.M. Baxley	Review of COLI operations.	0.50
05/23/02	J.W. Johnson	Research regarding issues related to COLI settlement.	2.50
05/24/02	S.G. Watters	Continue review of state legislative history regarding COLI.	1.00
05/24/02	J.M. Baxley	Review of COLI operations; further research re; review of COLI operations; revise memo.	6.00
05/24/02	J.W. Johnson	Research regarding issues relating to COLI settlement.	2.50
05/25/02	J.M. Baxley	Read cases; revise memorandum re: review of COLI operations.	5.00
05/26/02	J.M. Baxley	Research; revise memorandum re: review of COLI operations.	7.50
05/27/02	J.M. Baxley	Finalize first draft or memorandum re review of COLI operations.	5.00
05/27/02	J.W. Johnson	Preparation of Memorandum re COLI issues.	3.00

05/28/02	J.M. Baxley	Review of COLI operations in preparation for conference call with client.	3.50
05/29/02	J.W. Johnson	Research regarding impacting COLI settlement.	2.50
05/29/02	A.E. Moran	Follow-up re conference on COLI cases and settlement issues.	0.40
05/29/02	J.W. Johnson	Teleconference with client regarding COLI settlement issues.	2.00
05/29/02	J.M. Baxley	Phone conference with client re COLI operations.	2.00
05/29/02	J.M. Baxley	Begin further work re: review of COLI operations.	3.00
05/29/02	S.H. Serling	Prepare for and telephone conference with client regarding pending COLI litigation and IRS procedures (attended part).	1.30
05/29/02	A.E. Moran	Telephone conference re recent COLI cases and settlement issues (attended part).	1.30
05/30/02	A.E. Moran	Review and send information on COLI issues to client.	0.60
05/30/02	J.W. Johnson	Review issues re COLI settlement.	2.00
05/31/02	A.E. Moran	Telephone conference with R. Sentfleben re COLI case.	0.40
05/31/02	J.W. Johnson	Teleconference with client re COLI settlement research.	0.10
05/31/02	J.W. Johnson	Research re COLI settlement issues.	2.50
06/03/02	J.M. Baxley	Review of COLI operations; research; revise draft.	8.50
06/03/02	J.W. Johnson	Research regarding COLI issues and settlement.	1.00
06/03/02	A.E. Moran	Review issues regarding COLI claims.	1.40
06/04/02	J.M. Baxley	Review of COLI operations; additional research.	9.00
06/04/02	J.W. Johnson	Analysis of settlement questions related to COLI questions.	2.50
06/05/02	J.M. Baxley	Finalize document re: review of COLI operations.	4.00
06/05/02	J.W. Johnson	Draft memorandum re COLI settlement analysis.	3.50
06/06/02	J.W. Johnson	Draft memorandum re COLI settlement issues.	0.80
06/07/02	J.M. Baxley	Work on review of COLI operations; review transmittal.	0.50
06/07/02	J.W. Johnson	Analysis of COLI settlement issues.	1.50
06/12/02	A.L. Bailey	Analysis of COLI decisions.	1.00
06/13/02	B. Kaufman	Review of prior COLI NPAs and Grace Protest for 1990-92 years; drafting of Response to COLI NPA	1.40
06/13/02	J.W. Johnson	Meeting with B. Kaufman re COLI NPA.	0.30
06/13/02	J.W. Johnson	Preparation of COLI protest.	0.20
06/13/02	B. Kaufman	Meeting with A. Moran re: drafting of Response	

		to COLI NPA for early referral purposes	0.20
06/13/02	B. Kaufman	Phone call with C. Finke re: drafting of Response to COLI NPA for early referral purposes	0.30
6/13/02	B. Kaufman	Meeting with W. Johnson re: Response to COLI NPA	0.30
06/14/02	B. Kaufman	Review of COLI NPA; preparation of Response to COLI NPA	4.00
06/17/02	B. Kaufman	Review of COLI NPA; preparation of Response to COLI NPA	5.70
06/17/02	J.W. Johnson	Preparation of COLI response.	2.00
06/18/02	B. Kaufman	Preparation of Response to COLI NPA	3.40
06/18/02	A.E. Moran	Review COLI draft.	0.80
06/18/02	A.E. Moran	Meet with B. Kaufman re draft.	0.20
06/18/02	J.W. Johnson	Review and revise draft COLI protest; review Form 5701-12	9.00
06/19/02	J.W. Johnson	Consider NPA response on COLI.	0.50
06/20/02	J.W. Johnson	Teleconference re status of COLI Protest to IRS.	0.50
06/20/02	A.E. Moran	Office consult with B. Kaufman re COLI draft.	0.20
06/20/02	A.E. Moran	Telephone conference with C. Finke re COLI draft.	0.20
06/20/02	A.E. Moran	Review COLI draft.	1.10
06/24/02	J.W. Johnson	Meeting with B. Kaufman re revisions to submission to IRS re COLI insurance.	0.60
06/25/02	J.W. Johnson	Review and revise COLI protest per comments from Tom Borders.	2.30
06/28/02	J.W. Johnson	Revisions to IRS COLI submission.	2.00

RESPONSE EXHIBIT 1

Below please find an overall description of the tasks performed with respect to the corporate owned life insurance (“COLI”) policies held by W.R. Grace (“Grace”) in April - June 2002, which were questioned by the auditor. Steptoe performed all of these tasks at Grace’s direction, and in anticipation of litigation with the IRS in connection with the interest deductions that W.R. Grace had taken on certain corporate owned life insurance policies (hereinafter called “COLI policies”) that Grace had purchased in 1988 and 1990. The IRS had already audited Grace for the tax years 1990-92 and disallowed the deduction for interest for those years; Grace had appealed this disallowance unsuccessfully, and at this point was anticipating litigation.

A number of events were happening simultaneously at this time. First, although Steptoe and Grace had previously determined prior to this time that they would litigate this matter for the tax years 1990-92, it became apparent in the spring of 2002 that other taxpayers were starting to lose COLI cases in court. In addition, rumors had begun to circulate that the IRS would withdraw the general settlement offer that it was offering to taxpayers and therefore Grace once again had to decide whether they needed to settle quickly or try to continue with its plan to litigate. At the same time, Grace knew that the IRS had almost completed its review of deductions for interest for the 1993-96 tax years (each set of tax years starts a new process and IRS review procedure), and was likely to deny deductions for those years as well. It seemed that this might be a good time to consider settlement again. In addition, Grace had to take the necessary procedural steps required to preserve its claims that it was entitled to a deduction for 1993-96 after the IRS denied the deduction. Very generally, it had to file a “protest” with the IRS, which is like a brief explaining its position and responding to the IRS position. Grace also had to decide whether to take advantage of some IRS

programs that permit “early referral” or “fast-track referral” of certain previously considered cases (cases considered for other taxpayers) to the appropriate IRS appeals officer. In the middle of these decisions, there arose certain state law cases affecting corporate owned life insurance policies. All of these issues had to be considered as Grace debated the question of whether to settle or continue to litigate. So, in summary, in these three months, Steptoe generally tried to (a) determine whether the IRS would or would not continue to allow settlement, and on what terms, (b) put Grace in the best procedural position to preserve its claims while pursuing the possibility of settlement, (c) analyze the state law case and issues that arose under state law with respect to COLI benefits, and (d) prepare the required “protest” brief defending Grace’s interest deductions. A protest has to be filed whether or not the taxpayer settles.